Nos. 18505 and 18776

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 18505

UNITED STATES OF AMERICA and R. A. RIDDELL, District Director of Internal Revenue, Los Angeles District,

Appellants,

vs.

MONOLITH PORTLAND MIDWEST COMPANY,

Appellee,

No. 18776

MONOLITH PORTLAND CEMENT CO.,

Appellant,

vs.

R. A. RIDDELL, District Director of Internal Revenue, Los Angeles District,

Appellee.

On Appeals From the Judgments of the United States District Court for the Southern District of California.

Consolidated Brief for the Appellants in No 18505 and for the Appellee in No. 18776.

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Prior Opinions.

Monolith (Case No. 18776)[1]: The original findings of fact and conclusions of law of the District Court (R. 168-185) are not officially reported. The opinion of this Court affirming the original judgment of the

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[1]Two separate cases involving a common issue have here been consolidated for briefing, argument and presentation to this Court. (See R. 848-852.) To distinguish between the two cases, we shall refer to the appellant in Case No. 18776 as "Monolith" and to the appellee in Case No. 18505 as "Midwest." We shall

District Court (R. 749-772) is reported at 301 F. 2d 488. The opinion of the Supreme Court, summarily reversing this Court and remanding the case, is reported at 371 U.S. 537. The findings of fact and conclusions of law of the District Court on the remand (R. 828-831) are not officially reported.

Midwest (Case No. 18505): The findings of fact and conclusions of law of the District Court (MR. 1292-1311) are not officially reported.

Jurisdiction.

Monolith (Case No. 18776): This appeal involves income taxes for the calendar year 1952. The income tax liability of $156,286.65 shown on the taxpayer's 1952 return was paid by the taxpayer in 1953. (R. 175.)[2] An additional $25,396.60, plus interest of $5,002.43, was assessed against it and paid in 1956. (R. 175-176.) On or about February 24, 1956, within the time allowed by law, the taxpayer filed a claim for refund of $99,070.81 in taxes paid for 1952 (R. 39-43, 176), which was disallowed by letter dated September 27, 1956 (R. 176). On or about May 17, 1956 (within three years of the date the 1952 return was filed), the taxpayer and Commissioner of Internal Revenue (through the District Director) executed a proper

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refer to the record in *Monolith* as "R." and use "MR." for the *Midwest* record. In our explanation of the proceedings in the two cases we shall give precedence to the *Monolith* case, despite the lower number it carries in this Court, because *Monolith* has a longer history and was decided by the Supreme Court.

[2]Some of the record references used in this jurisdictional statement as to No. 18776 are to the District Court's *original* findings of fact, which were later vacated. The new findings do not contain details related to jurisdictional matters except through incorporation of the pre-trial conference order, which is contained in a volume entitled Exhibits that is not paginated.

form extending to June 30, 1957, the period of limitations for the calendar year 1952. (R. 176.) On December 27, 1957, within six months of the extended period of limitations and two years following the taxpayer's payment on August 14, 1956, of the additional tax ($25,396.60) and interest ($5,002.43) assessed against it, the taxpayer filed two more claims for refund, one in the amount of $181,683.24 and the other in the amount of $82,612.44, which were never either allowed or disallowed. (R. 176-177.) On May 15, 1958, within the time provided in Section 3772 of the Internal Revenue Code of 1939 the taxpayer brought this action in the District Court (R. 3-38) for a refund of taxes which included a claim for taxes paid for 1952 in the total amount of $186,753.40 (R. 21-22, 46; see also, R. 143-144).[3] Jurisdiction was conferred on the District Court by 28 U.S.C., Section 1346. On the taxpayer's motion for summary judgment (see R. 168), the court on December 17, 1959, entered judgment in favor of the taxpayer in the principal amount of $186,753.40, plus interest (R. 184-185). Within 60 days thereafter, on February 19, 1960, a notice of appeal was filed by the District Director. (R. 187.) Jurisdiction was conferred on this Court by 28 U.S.C., Section 1291. On March 23, 1962, this Court affirmed the judgment of the District Court. (R. 748.) A petition for rehearing filed by the Director was denied on May 22, 1962. By orders of Mr. Justice Douglas, entered on August 13 and September 20, 1963, the time for filing a petition for a writ of certiorari was ex-

[3]The complaint contained five causes of action, the last four of which claimed refunds for the years 1953 and 1954. Those four causes of action were dismissed pursuant to stipulation of the parties. (See R. 163-164.)

tended to October 16, 1962. On October 15, 1962, the Director filed a petition for a writ of certiorari, invoking the jurisdiction of the Supreme Court under 28 U.S.C., Section 1254(1). On January 14, 1963, the Supreme Court granted the petition for certiorari, summarily reversed the judgment of this Court, and remanded the case to the District Court for disposition in accordance with its opinion. (R. 773-776.) On March 4, 1963, on the District Court's own motion, the mandate of the Supreme Court was filed in and spread upon the records of the District Court. (R. 746.) On May 10, 1963, the District Court vacated its prior findings of fact, conclusions of law and summary judgment; entered new findings of fact and conclusions of law; and entered judgment dismissing the taxpayer's action. (R. 828-831.) On June 28, 1963, the taxpayer filed a timely notice of appeal (R. 831-832) invoking this Court's jurisdiction under 28 U.S.C., Section 1291.

Midwest (Case No. 18505): This appeal involves income taxes for the calendar years 1951 and 1952. The taxpayer duly paid the income tax liabilities shown on its returns for those years. (MR. 1299-1300.) On or about February 15 and March 9, 1955, within the time allowed by law, the taxpayer filed claims for refund of 1951 taxes paid. (MR. 105.) On or about February 24, 1956, within the time allowed by law, the taxpayer duly filed a claim for a refund of 1952 taxes paid. (MR. 106.) The Commissioner neither allowed nor disallowed the claims for refund. (MR. 106.) On June 19, 1958,

within the time provided in Section 3772 of the Internal Revenue Code of 1939, the taxpayer brought suit in the District Court for the recovery of taxes paid in 1951 and 1952. (MR. 2-31.) Jurisdiction was conferred on the District Court by 28 U.S.C., Section 1346. On October 2, 1959, the United States filed a complaint in intervention to recover additional taxes assessed against the taxpayer for the years 1951 and 1952 on December 24, 1958, and September 25, 1959. (MR. 191-194.) The District Court had jurisdiction of the complaint in intervention under 28 U.S.C., Sections 1340 and 1345. Judgment of the District Court in favor of the taxpayer was entered on September 25, 1962 (MR. 1306) and was amended *nunc pro tunc* on November 13 and December 19, 1962 (MR. 1325-1328). A motion for a new trial was denied on October 10, 1962. (MR. 1322.) Within 60 days, on December 6, 1962, the United States filed notice of appeal. (MR. 1329.) Jurisdiction is conferred on this Court under 28 U.S.C., Section 1291.

Question Presented.

Whether collateral estoppel or any other theory argued by the taxpayers permits disregarding the Supreme Court's holding in *Monolith* (Case No. 18776 in this Court), that the "mining" of limestone, within the meaning of Section 114(b)(4)(B) of the Internal Revenue Code of 1939, terminates when the limestone reaches the crushed stage.

Statute and Regulations Involved.

The pertinent statutory provisions and Treasury Regulations are printed in Appendix A, *infra*.

Statement.

Monolith.
(Case No. 18776.)

Monolith is an integrated miner-manufacturer which in the taxable year (1952) was engaged in the manufacture and sale of finished cement from its plant at Monolith, California, adjacent to which it operated an extensive mineral deposit of limestone from which it extracted limestone and used it exclusively to manufacture cement in its plant. (R. 828-829.) As a miner, it was entitled to a percentage depletion allowance. Under Section 114 of the Internal Revenue Code of 1939 this is in the amount of a specified percentage of its "gross income from mining" (subject to a limitation of 50 percent of net income from mining), for the purposes of which "mining" is defined as including not only the extraction of the mineral from the ground but also "the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products * * *."

In its 1952 income tax return, Monolith computed its percentage depletion allowance in accordance with the pertinent Treasury Regulations, *i.e.*, by applying a 10 percent rate[4] to a gross income from mining which

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[4]We originally contested this rate on the ground that the limestone was classified as "marble" or "stone" (both of which carry a 5 percent rate). The issue is no longer in the case by reason of its abandonment after its rejection by the District

was computed by using "Through Raw Grind" (R. 127), which the taxpayers now call the "slurry" stage (Br. 10), as the cut-off point to "mining"[5] (R. 127, 175; Br. 10).[6] This computation was accepted by the Commissioner, with certain minor adjustments. (R. 175-176, 829; Br. 11.)

After paying its taxes for 1952 (R. 175-176), Monolith filed claims for refund (R. 39-43, 176-177) and later instituted this suit (R. 3-22) on the ground that its "gross income from mining" (its depletion base) was its gross receipts from sales of finished cement (the

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Court (R. 172) and by this Court (R. 753-754, 770-771) on a prior appeal in the case.

Ordinary limestone is depletable under the statutory classification of "calcium carbonates" (see *H. Frazier Co. v. United States,* 302 F. 2d 521 (Ct. Cl.)) and carries a 10 percent rate. Chemical and metallurgical grade limestone are depletable under those classifications and carry a 15 percent rate. The District Court did not decide which limestone classification Monolith's limestone falls into because it was unnecessary. (See R. 172.)

[5]The processes which the taxpayer used in mining its limestone and manufacturing it into cement are correctly set forth in paragraph 12 of Monolith's complaint (R. 173), which appears at R. 6-9. These processes may be summarized as follows: blasting the face of the quarry; several crushing processes; transportation to its plant two miles away; blending the limestone with small amounts of clay, silica, iron cinders, and fluorspar; adding water and making a "slurry" of the blended material; grinding the slurry; heating the slurry in a rotary kiln, where the water is evaporated and the remaining material is chemically combined into a dense "clinker"; adding a small amount of gypsum to the clinker and grinding it to a very great fineness. At this point, cement has been produced.

The taxpayers explain (Br. 10, fn.) that the "slurry" stage "is the pre-kiln state in processing just before the crushed, ground and blended raw material (in semi-liquid form) are fed into the kiln."

[6]As already indicated (see fn. 2, *supra*) we, like the taxpayers, shall at times refer to the *original* findings of fact of the District Court because the pre-trial conference order incorporated into the new findings and showing these facts is not paginated.

manufacture of which includes the addition of small amounts of other materials, both purchased and mined, see fn. 5, *supra,* and R. 146). Among other things, Monolith alleged that the Government was barred and estopped from contesting that claim by reason of the court's holding in a prior refund suit by Monolith involving the year 1951. (See R. 14-20.) The Government defended the 1952 suit, in which Monolith sought a tax refund of $186,753.40 for 1952,[7] on the ground that "mining" terminated with the primary crushing process (R. 86, 90, 91, 137), which was even prior to the cutoff point the Commissioner had allowed Monolitth (see fn. 5, *supra*).[8]

On Monolith's motion for summary judgment (R. 104-105) the following were undisputed facts of record:

Limestone is widely distributed in the United States, has the greatest variety of uses of any rock quarried, and is used more extensively than any other type of stone. (Ex. A, R. 353, p. 25; see also, R. 74.) Among other things, limestone is used as the basic, necessary raw material in making cement. (R. 62, 113, 114.) Cement is a "manufactured" product. (Ex. C, R. 463,

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[7]The portion of Monolith's complaint covering the years 1953 and 1954 (R. 22-38) was dismissed on stipulation of the parties (see R. 163-164).

[8]As already noted (fn. 5, *supra*), we also contended, unsuccessfully, that the taxpayer was not entitled to a 10 percent depletion rate. Monolith also contended that it was entitled to an even higher rate than that used in its 1952 return, *i.e.,* a 15 percent rate on the theory its limestone was of chemical grade. The District Court found it unnecessary to decide between ordinary limestone depletable as "calcium carbonate" at a 10 percent rate and chemical grade limestone depletable at a 15 percent rate. (See R. 172-173.)

pp. 3, 13; Ex. D, R. 399, p. 1; Pltf. Ex. 14, R. 693, p. 14.)[9]

The limestone industry is divided into two distinct branches according to usage—(1) dimension stone and (2) crushed and broken stone. (Ex. F, R. 525, p. 1; Pltf. Ex. 14, R. 693, p. 2; see also Ex. A, R. 353.) Monolith does not mine dimension stone; it blasts the limestone from the face of the quarry and crushes it for use in manufacturing cement. (R. 6-7, 173.)

In 1952 (the taxable year) there were approximately 297,000,000 tons of crushed and broken limestone sold or used by producers in the United States. (Ex. A, R. 353, p. 29; Pltf. Ex. 14, R. 693, p. 12.) Excluding the substantial tonnage used in manufacturing cement (see Ex. C, R. 463, p. 13) and that used to make lime, which are reported "in terms of finished products" in the Cement and Lime chapters of the Minerals Yearbooks annually issued by the United States Bureau of Mines (Ex. A, R. 353, pp. 1, 29), over 216,000,000 tons of limestone (including chemical and metallurgical grade) with an average value of $1.36 a ton, were sold or used by producers in crushed or broken form in the United States in 1952. (*Id.*, pp. 26-27.) Of that total, over 1,500,000 tons were sold or used by producers in California (in addition to that used to manufacture cement). (*Id.*, p. 26.) There are eight grinding plants in California alone which purchase and process limestone. (Ex. I, R. 599, p. 15.)

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[9]The production of cement includes the heating of blended materials in a rotary kiln which causes a chemical change to occur in the materials. (R. 9, 106.)

The District Court granted Monolith's motion for summary judgment (R. 162-163) and filed findings of fact and conclusions of law (R. 168-185). The latter were prefaced by an explanation that in the court's view, because of this Court's prior decision in *Monolith Portland Cement Co. v. United States,* 269 F. 2d 629 (C.A. 9th), the issues "are not now available to the defendant here, under the doctrines of res judicata and collateral estoppel" (R. 169) but that "the Court prefers not to rest its decision solely on the ground of res judicata" (R. 170). The court further found and concluded "that the issues tendered * * * are issues of law and not of fact". (R. 170.) The District Court's findings of fact, on which its conclusions on the merits were based, included findings that "There was not at any time during the taxable calendar year 1952, any commercial market, within the market area available to * * * [Monolith], for the limestone extracted and used by * * * [Monolith] * * * except for the finished cement sold by [Monolith] * * *" (R. 171-172) and that in 1952 "it was not economically or commercially feasible for * * * [Monolith] to use any of such limestone in the production of * * * crushed limestone" (R. 173). On the basis of those findings, the District Court concluded (R. 182) that "The treatment processes applied by * * * [Monolith] to its limestone in order to produce cement in 1952 were ordinary treatment processes normally applied by mine owners and operators within the meaning of Section 114(b)(4)(B) of the Internal Revenue Code of 1939, as amended" and that "The commercially marketable mineral product [referred to in the statutory definition of "mining"] obtained

by * * * [Monolith] from mining its limestone and mineral deposit in 1952 was finished bulk Portland cement ready for shipment at its plant at Monolith, California."

As a result of the increase in Monolith's depletion allowance, judgment was entered in its favor for a refund of taxes in the amount of $186,753.40 plus interest. (R. 184-185.) This amounted to a holding that Monolith should not have paid any income tax at all for 1952 (the total taxes and interest paid for that year being $186,753.40, see (R. 175-176).

On the Government's appeal, this Court affirmed the judgment of the District Court. (R. 748-772.) On the res judicata and collateral estoppel aspect, the Court stated (R. 772) that "Though we might well agree with the district court's conclusion that res judicata and collateral estoppel bar consideration of appellant's contentions, we too have preferred to go to the merits of the issues". In deciding the merits, the Court upheld the District Court's conclusion that Monolith was entitled to a depletion allowance on its finished cement. The Court's holding appears to have been based on the view that the First Circuit's decision in *Dragon Cement Co. v. United States,* 244 F. 2d 513, certiorari denied, 355 U.S. 833, represented "existing law" rather than a decision of the Supreme Court which had been rendered pending the appeal in the *Monolith* case and which interpreted the statutory definition of "mining", *i.e., United States v. Cannelton Sewer Pipe Co.,* 364 U.S. 76. In any event, this Court twice took note of the holding in *Cannelton* that integrated miner-manufacturers are their own market for the mineral they mine (R. 757-758, 765) but held *Cannelton* "to be dis-

tinguishable" (R. 765) and stated that it "does not apply to the fact issues presented in the instant case" (R. 768).

The Government filed a petition for a writ of certiorari, on which the Supreme Court summarily reversed this Court (R. 774-776) and remanded the case to the District Court for disposition in accordance with its opinion (R. 773, 776). In its opinion the Supreme Court stated that in *Cannelton* it had held that the cutoff point to "mining" was "at the point where the mineral first became suitable for industrial use or consumption" (R. 775); that, as to Monolith's mineral, "mining" terminated when the mineral "reached the crushed limestone stage" (R. 776); and that "This results in limiting the taxpayer's basis for depletion to its constructive income from crushed limestone, rather than from finished cement" (R. 776). In explanation of its holding that the cutoff point to mining was when the limestone reached the crushed stage, the Court pointed out that limestone is not only marketable in that form (*i.e.*, suitable for industrial use or consumption) but that the record showed that in 1952 it was actually sold in that form (in large quantities), both in the United States generally and in California.

On the Supreme Court's remand to the District Court, the latter court vacated its prior findings of fact, conclusions of law, and summary judgment (R. 828) and entered new findings of fact and conclusions of law (R. 828-831). The court found facts relating to the amount of crushed and broken limestone sold or used by producers in the United States in general and in California (R. 829-830), that Monolith's limestone was fit for industrial use or consumption when it reached

the crushed stage (R. 830), that mining ceased at that point for depletion purposes (R. 830), and "In compliance with the Supreme Court's mandate", that "the first 'commercially marketable mineral product' of the taxpayer's deposit for the calendar year 1952 was crushed limestone" (R. 830). The court made similar conclusions of law, adding that for depletion purposes the cutoff point to "mining" as to an integrated miner-manufacturer is at the point where the mineral first becomes suitable for industrial use or consumption and that Monolith's depletion base is its constructive income from crushed limestone, rather than its gross income from sales of cement less bagging, etc. (R. 830.) The result was a judgment dismissing Monolith's suit (R. 831), from which it has appealed (R. 831-832).

Midwest.
(Case No. 18505.)

In the taxable years (1951 and 1952) Midwest's common stock was all owned by Monolith, the taxpayer in Case No. 18776. It is a Nevada corporation conducting business in Wyoming and having its principal office in Los Angeles, California. (MR. 1294.)

Like Monolith, Midwest is an integrated miner-manufacturer whose principal business is the manufacture and sale of finished cement.[10] It has a plant at Laramie, Wyoming, and two limestone deposits adjacent thereto from which it extracts limestone which it uses in its own plant to manufacture cement (MR. 1294-1295) by a method which is the same as that used

[10]In relation to whether cement is a manufactured product, the District Court expressly found (R. 1299) that Portland cement cannot be made unless certain chemical reactions, resulting in the formation of new chemical compounds, occur in the calcination (or burning) process in the rotary kiln.

by Monolith (MR. 1298). In the taxable years all 585,000 tons of limestone Midwest mined were used by it to manufacture cement, except for 132 tons. (MR. 1296). Like Monolith, Midwest mined and purchased small amounts of other materials which it added to its limestone in manufacturing cement. (MR. 1296.)

In its 1951 and 1952 returns (MR. 500-539) Midwest computed its percentage depletion allowance on the basis of the pertinent Treasury Regulations (MR. 9, 19, 505, 527), *i.e.,* by using "Through Raw Grinding" (MR. 505, 527), which the taxpayers now call the "slurry" stage (Br. 11), as the cutoff point to "mining". After paying the income tax liabilities reported in the returns—$143,517.16 plus $55.40 in interest for 1951 and $28,025.50 for 1952 (MR. 1299-1300)—it filed claims for refund of taxes paid in those years based on the ground that its gross income from mining (its depletion base) was the sales price of its finished cement (MR. 18, 22, 32-48, 105-107). Subsequently, it instituted this suit for refund (MR. 2-22), alleging not only that it was entitled to depletion on finished cement but that it was entitled to use a 15 percent, instead of a 10 percent, depletion rate on the theory that its limestone was of chemical grade.[11] As to 1951, Midwest also alleged that the Government was barred and estopped from defending the cutoff point issue by reason of the first *Monolith* decision. (MR. 12-17.)

Subsequently, the United States, with leave of court, filed a complaint in intervention seeking to recover ad-

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[11]Midwest subsequently filed claims for refund which included this contention. (See MR. 567-583.) Its complaint also included causes of action covering the year 1954 but these were dismissed pursuant to stipulation of the parties. (See MR. 1171-1172.)

ditional taxes and interest for 1951 and 1952 which was assessed against Midwest pursuant to deficiency notices issued on August 19, 1958, and May 5, 1959. (MR. 189-194.) The latter deficiency notice was based on the ground (1) that the cutoff point to "mining" was at the crushed limestone stage (Br. 12) and (2) that Midwest's limestone was classifiable as "stone" and thus depletable at a 5 percent rate instead of a 10 percent rate. The complaint in intervention raised no new issue of fact or question of law (MR. 1293-1294), since the proper classification of Midwest's mineral was already in issue and from the outset (see MR. 12, 21, 30, 31, 33-34, 47-48) the Government had defended Midwest's suit on the ground that the cutoff point to "mining" was at the crushed limestone stage. On the other hand, acceptance of the crushed stone cutoff point entitled the United States to judgment for unpaid deficiency taxes.

After some preliminary proceedings in the case, including the filing of a motion for summary judgment by Midwest, the Supreme Court granted certiorari to review the decision of the Seventh Circuit in *Cannelton Sewer Pipe Co. v. United States,* 268 F. 2d 334. The District Court accordingly entered an order continuing further proceedings until the final decision of the Supreme Court in the *Cannelton* case. (See MR. 1185-1186.)

After the Supreme Court decided *Cannelton,* Midwest amended its complaint to claim that the *Cannelton* decision was distinguishable and that the Government was barred and estopped from claiming that it was applicable. (MR. 1226-1231, 1249-1250.)

In hearings prior to trial, the District Court took the view that under *Cannelton* the cutoff point to "mining" limestone was at the crushed stone stage only if the Government showed that, irrespective of profitability, in the taxable years (1951 and 1952) Midwest could actually have sold its limestone to someone else in crushed form. (See Tr. 40-46, 82-93, 104, 110, 130-134, 147, 153-155.) As a result, the evidence was rather extensive.

For present purposes, it is sufficient to note that the record contains excerpts from the Mineral Yearbook (1952), U.S. Bureau of Mines, which show that a total of over 216,000,000 tons of crushed and broken limestone was sold or used by producers in the United States in 1952 (excluding that used to make cement and lime) and that in Wyoming the amount was over 588,000 tons. (MR. 303, 328-329; see also, MR. 839-842, 843-845, 1236.) In addition, the record confirms Midwest's admissions on information and belief (MR. 1252-1253) that in the taxable years even some cement companies purchased crushed limestone. The following is a list of such companies and the number of tons of crushed limestone, in varying sizes, which they purchased in 1951 and 1952:[12]

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[12]This evidence is taken from depositions contained in the volume of exhibits, which is not paginated. We shall therefore refer to the deposition and its page number as record references.

	1951	1952
Medusa Portland Cement Co.[13]		
Plants at		
Manitowoc, Wis.	299,155	327,619
Wampum, Pa.	191,109	150,662
York, Pa.	150,612	135,760
Bay Ridge, Ohio	134,465	114,183
Diamond Alkali Co.[14]		
Standard Portland Cement Div.,		
Fairport Harbor, Ohio	345,296	299,703
Aetna Portland Cement Co.[15]		
Essexville, Michigan	All of its requirements	
Huron Portland Cement Co.[16]	1,825,207	1,887,944
Wyandotte Chemicals Corp.		
Cement plant at Wyandotte, Mich. tons per year.[17]	About 1,000,000	
American Cement Corp.[18]		
Peerless plant at Detroit	377,306	
Port Huron plant	330,807	
Marquette Cement Mfg. Co.[19]		
Milwaukee plant	Purchases made beginning in 1956 of about 300,000 tons per year	

[13]See Weigel deposition, p. 10, and tabular exhibit thereto.

[14]See Crichley deposition, p. 56, and exhibit thereto.

[15]See Calvin deposition, pp. 4, 6, 7.

[16]See Denby deposition, pp. 8-9, 11, 14, 17, 37.

[17]During the taxable years this company obtained its limestone from its own quarry about 200 to 250 miles away. It later sold the quarry and purchased all of its limestone. See Mericola deposition, pp. 8-9, 12, 16, 32.

[18]See Eichenlaub deposition, pp. 9-10, 12, 13-14, 18, 25-26.

[19]See Duncan deposition, pp. 10-13, 15, 20, 29.

	1951	1952
Pittsburgh Coke & Chemical Co.[20] Green Bag Cement Div., Pittsburgh, Pa.	198,369	158,669
Lehigh Portland Cement Co.[21] Buffalo plant	464,188	542,233

Deciding the case after this Court's decision in the *Monolith* case but before that decision was reversed by the Supreme Court, the District Court concluded that the "mining" of limestone included all of the processes employed by Midwest to manufacture its finished bulk cement[22] and, as an alternative to its holding on the merits, that the Government was collaterally estopped by the first and second *Monolith* decisions. (1305.) The holding on the merits of the cutoff point issue was based on findings (MR. 1297-1298, 1301) to the effect that, since there are extensive limestone deposits in almost every state in the country, Midwest's limestone was not commercially marketable as crushed stone because "No one would buy [Midwest's] limestone for any use at equal cost to such local limestone in view of the many problems of testing, transportation, control of quantity and continuity of delivery" (MR. 1301.)[23]

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[20]See Forbrick deposition, pp. 10-16.

[21]See Groll deposition, pp. 4-5, 7, 9.

[22]The court also found that Midwest's limestone is ordinary limestone depletable as "calcium carbonates" and thus at a 10 percent rate (MR. 1304) but neither party has appealed that issue.

[23]At the same time, the court conceded (1) that Midwest's limestone was suitable for use as agricultural limestone, concrete aggregate and asphaltic filler (MR. 1297) and (2) that cement is a manufactured product, since it also found as a fact (MR. 1299) that "Portland cement cannot be made unless these chemical reactions [from burning in the kiln] have occurred and unless the chemical reactions create the new compounds in certain acceptable proportions."

Specification of Errors Relied Upon.

Midwest (Case No. 18505.)

The District Court erred—

1. In holding that the "mining" of limestone, within the meaning of Section 114(b)(4)(B) of the Internal Revenue Coe of 1939, includes all of the processes Midwest employed in making finished bulk cement and in failing to hold that the cutoff point to "mining" is when the limestone reaches the crushed stage.

2. In concluding that Midwest's limestone and other minerals mined by it were not commercially marketable mineral products prior to being made into cement.

3. In holding that Midwest is in privity with its parent for collateral estoppel purposes and that the Government is collaterally estopped by prior decisions involving its parent.

4. In relying upon *James v. United States,* 366 U.S. 213, as establishing applicable principles of res judicata and estoppel by conduct.

Summary of Argument.

These two cases, which have been consolidated in this Court for briefing and argument purposes, present a single question, *i.e.,* the point at which the "mining" of limestone terminates within the meaning of Section 114(b)(4)(B) of the Internal Revenue Code of 1939. The holdings of the District Court in the two cases are directly opposed—in *Midwest* that the cutoff point is at finished bulk cement and in *Monolith* that the cutoff point is when the mineral reached the crushed limestone stage—because *Midwest* was decided before the Supreme Court summarily reversed this Court's decision in *Monolith* whereas the District Court's *Mono-*

lith decision was entered in compliance with the Supreme Court's mandate in that case.

In *Monolith,* this Court had affirmed the District Court's holding that "mining" included all of the processes employed by Monolith to manufacture finished bulk cement. In reversing this Court, the Supreme Court explained that the case is controlled by its prior decision in *United States v. Cannelton Sewer Pipe Co.,* 364 U.S. 76. Applying the law of that case to the mining of limestone, the Supreme Court held that the "mining" of limestone terminated when the mineral "reached the crushed limestone stage" and that "This results in limiting the taxpayer's basis for depletion to its constructive income from crushed limestone, rather than from finished cement." That holding is equally applicable to the *Midwest* case.

There is no merit in the taxpayers' contention that a prior *Monolith* case, involving a different taxable year, bars application of the Supreme Court's *Monolith* decision on res judicata and collateral estoppel principles. In that first case, "mining" was held to extend to finished bulk cement. While that holding was consistent at the time with outstanding Court of Appeals decisions involving the interpretation and application of the statutory definition of "mining", there was a doctrinal change in the law when the Supreme Court interpreted and applied the statutory definition of "mining" in *Cannelton,* as conclusively evidenced by the Supreme Court's subsequent application of *Cannelton* in *Monolith* as requiring a holding that the "mining" of limestone terminated when the mineral reached the crushed limestone stage. A doctrinal change in the law precludes application of res judicata and collateral estoppel, as

the Supreme Court held in *Commissioner v. Sunnen,* 333 U.S. 591.

It is anomalous, to say the least, for the taxpayers to argue, as they do, that in its *Monolith* opinion the Supreme Court did not consider what "existing law" was as to integrated cement manufacturers such as these taxpayers who did not make the statutory election accorded them by Congress, after *Cannelton,* to use the pre-kiln feed stage as the cutoff point to "mining". This is exactly what the Supreme Court decided in *Monolith.* Its holding—that "mining", as to *Monolith* (and others similarly situated), terminated when the mineral reached the crushed stage—overruled the contrary view of "existing law" which this Court had taken in that case.

The taxpayers' complaint regarding "retroactivity" is misconceived. It amounts simply to saying that Supreme Court decisions interpreting and applying a statute should not be given effect because lower courts have previously interpreted the statute differently. *James v. United States,* 366 U.S. 213, on which the taxpayers rely, involved a different type of situation, *i.e.,* one where the Supreme Court overruled one of its own prior decisions. Moreover, *James* was a criminal case and all that the Supreme Court there held, so far as pertinent here, is that, since its prior decision was outstanding at the time the alleged crime was committed, the taxpayer could not be said to have "willfully" committed that crime. While the taxpayers' attempt to bolster their "retroactivity" argument with assertions of injustice to them, these assertions are groundless. The taxpayers only real complaint is that because of the Supreme Court's *Monolith* decision they will not receive the tax windfall they sought.

ARGUMENT.

THE TAXPAYERS HAVE ADVANCED NO VALID REASON FOR DISREGARDING THE HOLDING OF THE SUPREME COURT IN THE MONOLITH CASE THAT THE "MINING" OF LIMESTONE, WITHIN THE MEANING OF SECTION 114(b)(4)-(B) OF THE INTERNAL REVENUE CODE OF 1939, TERMINATE WHEN THE MINERAL REACHED THE CRUSHED LIMESTONE STAGE.

A. The Supreme Court's Holding in the Monolith Case Is Equally Applicable to the Midwest Case.

On the merits as to the cutoff point to the "mining" of limestone within the meaning of Section 114(b)-(4)(B) of the Internal Revenue Code of 1939 (Appendix A, *infra*), the Government contended in both the *Monolith* and *Midwest* cases that the cutoff point was at the crushing stage. In the light of evidence that vast amounts of crushed and broken limestone are annually sold or used by producers in the United States, that position, in our view, was supported by *United States v. Cannelton Sewer Pipe Co.*, 364 U.S. 76, in which the Supreme Court interpreted and applied the statutory definition of "mining" in relation to a miner of the minerals fire clay and shale. The Court there stated that the cutoff point to "mining" has always been where the ordinary, nonintegrated, run-of-the-mill miner shipped the product of his mine; that "mining" does not include processes which only an integrated operator has occasion to use; that integrated miner-manufacturers are their own market for the mineral they mine and, in sum, that the cutoff point to "mining" is at the stage where the mineral becomes fit for in-

dustrial use or consumption—a point which, in that case, was shown by sales of the minerals in their raw form.

Any doubt of the correctness of our position was removed when the Supreme Court summarily reversed this Court's decision in *Monolith (Riddell v. Monolith Cement Co.,* 371 U.S. 537) and remanded the case to the District Court for disposition in accordance with its opinion. In that opinion (see R. 773-776) the Supreme Court explained that in *Cannelton* it had held that the cutoff point to "mining" within the meaning of Section 114(b)(4)(B), is "at the point where the mineral first became suitable for industrial use or consumption". (R. 775.) Applying that holding to the facts of record regarding the mining of limestone, *i.e.,* evidence that vast amounts of crushed and broken limestone are annually sold or used by producers in the United States, the Court expressly held that "mining" terminated at the point where the mineral "reached the crushed limestone stage" (R. 776) and further stated (R. 776) that "This results in limiting the taxpayer's basis for depletion to its constructive income from crushed limestone, rather than from finished cement". In compliance with the Supreme Court's mandate remanding the case for disposition in accordance with its opinion (R. 773, 776), the District Court held that mining terminated when the mineral reached the crushed stage (R. 829-830). That holding is uncontrovertible.

The holding is equally applicable to the *Midwest* case and requires rejection of the District Court's holding in that case that "mining" includes all of the processes employed by Midwest to manufacture finished bulk ce-

ment. This holding of the District Court, rendered before the Supreme Court's *Monolith* decision, was based on an interpretation of *Cannelton* as meaning that, as applied to limestone, "mining" did not terminate at the crushing stage unless the Government could show that during the taxable years (10 years prior to trial) Midwest could actually have sold its limestone at that point *to others* (regardless of profitability). (See Tr. 40-46, 82-93, 104, 110, 130-134, 147, 153-155; MR. 1297-1298, 1301.) This interpretation of *Cannelton* is erroneous, as shown by the Supreme Court's subsequent *Monolith* opinion. Since the integrated miner-manufacturer is his own market for the limestone he mines, there is no question of marketability. The only inquiry is as to the point at which the mineral becomes marketable, meaning fit for industrial use or consumption, and is thus sold by the integrated operator, as a miner, to himself as a manufacturer. That point is conclusively established to be at the crushing stage in view of the evidence that large quantities of crushed and broken limestone are annually sold or used by producers in the United States in crushed and broken form.

We do not interpret the taxpayers' arguments to include a contention that under the Supreme Court's *Cannelton* and *Monolith* decisions the cutoff point to the "mining" of limestone is beyond the point where the mineral reached the crushed stage. While the taxpayers make certain assertions in their statement of facts regarding the marketability of their limestone (Br. 7-9), those assertions are not a part of their argument. Moreover, the assertions are erroneous because the word "market" is used improperly. Nor is there any issue in the case regarding the amount of crushing

included in "mining".[24] Unless the Supreme Court's *Monolith* decision is shown to be inapplicable to these taxpayers (as they argue), the District Court properly dismissed Monolith's cause of action (R. 831) and in the *Midwest* case the District Court's judgment should be reversed and the case remanded for entry of judgment in favor of the United States upon its counterclaim.

B. Neither Res Judicata nor Collateral Estoppel Bar Application of the Supreme Court's Holding in the Monolith Case to Monolith and Midwest.

Apparently relying upon the decisions of the District Court and of this Court in the first *Monolith* case,[25] the taxpayers contend that the Supreme Court's decision in *Monolith* cannot be given effect as to either Monolith or Midwest because of res judicata and collateral estoppel principles.[26] Those principles, as applied to tax cases, were discussed at some length by the Supreme Court in *Commissioner v. Sunnen,* 333 U.S. 591. The Court there pointed out (pp. 597-599) that

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[24]As shown in the Statement, *supra, Monolith* was administratively allowed a cutoff point at the "slurry" stage, beyond crushing. In the *Midwest* case the Government intervened and filed a counterclaim on the basis of a deficiency notice which used a cutoff point to "mining" which was not as far as previously allowed but which did, however, allow all crushing done prior to blending with other minerals.

[25]*Monolith Portland Cement Co. v. United States,* 169 F. Supp. 692 (N.D. Calif.); *Monolith Poartland Cement Co. v. United States,* 269 F. 2d 629 (C.A. 9th).

[26]In the *Midwest* case the District Court held (MR. 1304-1305) that the Government was estopped by both the first and second *Monolith* decisions of this Court. Since the Court's second *Monolith* decision was reversed by the Supreme Court, it obviously cannot operate as an estoppel.

res judicata applies only where the two actions are the same and that in tax cases a proceeding involving one taxable year is not the same cause of action as a proceeding involving another taxable year. Thus, the Supreme Court stated (p. 598) that—

> Income taxes are levied on an annual basis. Each year is the origin of a new liability and of a separate cause of action. Thus if a claim of liability or non-liability relating to a particular tax year is litigated, a judgment on the merits is *res judicata* as to any subsequent proceeding involving the same claim and the same tax year. But if the later proceeding is concerned with a similar or unlike claim relating to a different tax year, the prior judgment acts as a collateral estoppel only as to those matters in the second proceeding which were actually presented and determined in the first suit.

It follows that res judicata does not apply in present cases. The first *Monolith* case involved the year 1951 whereas the present *Monolith* case involves the year 1952. While the *Midwest* case involves both years, res judicata can hardly apply as to it when it does not apply to the very party to the proceeding (Monolith) with which it claims privity.

As to collateral estoppel, the following explanation of the Supreme Court in *Sunnen* (pp. 599-600) is pertinent:

> But collateral estoppel is a doctrine capable of being applied so as to avoid an undue disparity in the impact of income tax liability. * * * That principle is designed to prevent repetitious lawsuits over matters which have once been decided and which have remained substantially static,

factually and legally. It is not meant to create vested rights in decisions that have become obsolete or erroneous with time, thereby causing inequities among taxpayers.

And so where two cases involve income taxes in different taxable years, collateral estoppel must be used with its limitations carefully in mind so as to avoid injustice. It must be confined to situations where the matter raised in the second suit is identical in all respects with that decided in the first proceeding and where the controlling facts and applicable legal rules remain unchanged * * * a judicial declaration intervening between the two proceedings may so change the legal atmosphere as to render the rule of collateral estoppel inapplicable. * * * Tax inequality can result as readily from neglecting legal modulations by this Court as from disregarding factual changes wrought by state courts. In either event, the supervening decision cannot justly be ignored by blind reliance upon the rule of collateral estoppel.

Further, the Court stated in *Sunnen* (p. 601) that—

And if the very same facts and no others are involved in the second case, a case relating to a different tax year, the prior judgment will be conclusive as to the same legal issues which appear, *assuming no* intervening doctrinal change. But if the relevant facts in the two cases are *separable,* even though they be similar or identical, collateral estoppel does not govern the legal issues which recur in the second case. (Italics supplied.)

Assuming that the first *Monolith* case involved facts which are identical to and inseparable from those of

the present cases, as well as that it involved an identical question of law, it is apparent that collateral estoppel is inapplicable to the present cases because of a doctrinal change in the law. In the first *Monolith* case the District Court held that the "mining" of limestone as to Monolith included all of the processes it employed to manufacture bulk cement. That holding (only partially affirmed by this Court, since the Government appealed only on the additives issue) was based on decisions such as *Dragon Cement Co. v. United States,* 244 F. 2d 513 (C.A. 1st), certiorari denied, 355 U.S. 833. The first *Monolith* decision, the *Dragon Cement* decision, and all other decisions like them holding that taxpayers were entitled to depletion on their finished products, are no longer the law. In the first place, *United States v. Cannelton Sewer Pipe Co.,* 364 U.S. 76, in which the Supreme Court interpreted and applied the statutory definition of "mining", now precludes the result reached in those cases. And, if that were not enough, the doctrinal change in the law is conclusively demonstrated by the Supreme Court's holding (R. 774-776), as applied to *Monolith* itself, that the "mining" of limestone terminated when the mineral reached the crushed stage and that Monolith's depletion base was its constructive income "from crushed limestone, rather than from finished cement" (R. 776). The questions which the taxpayers assert were involved in the first *Monolith* case—"the 'market' for Monolith's mineral, and what processes are necessarily applied to obtain a 'commercially marketable product' "

(Br. 74)[27]—are the very questions which the Supreme Court decided in this second *Monolith* case, and contrary to the first *Monolith* decision of the District Court and of this Court. Surely the ultimate in incongruity would be reached if Monolith were to deny (instead of avoiding this aspect of collateral estoppel) that no change in doctrinal law has occurred when (1) it seeks a cutoff to "mining" at finished cement on the theory that *Dragon Cement* and the first *Monolith* case are the law (Br. 71-72) and (2) the Supreme Court has said, in a second *Monolith* case, that the cutoff point is when the limestone has reached the crushed stage.

The taxpayers make a point (Br. 75-76), the purpose of which we do not quite fathom, to the effect that the Supreme Court did not consider the matter of res judicata and collateral estoppel in deciding *Monolith*. Actually, it may well have, since the matter was called to its attention in our petition for certiorari. (See footnote 2 of our petition for certiorari at page 14 of the appendices to the taxpayers' brief.) But whether it did or not is certainly immaterial in view of the fact that the law had already been changed by *Cannelton* and collateral estoppel was therefore clearly inapplicable.

The taxpayers also argue (Br. 77-79) that the "new legal rule" (R. 79) should be applied only prospectively and that collateral estoppel should be applied to past

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[27]The taxpayers also refer to the question of "Monolith's statutory class of mineral" (Br. 74) but this is no longer an issue as to either Monolith or Midwest.

years in order to prevent inequality, discrimination and injustice. But the allegations of inequality, discrimination and injustice are based simply on the fact (see Br. 77-78) that, pursuant to relief legislation, all but six of the almost 200 cement producers elected to use a kiln-feed cutoff as to pre-1961 tax years.[28] These taxpayers were also entitled to make that election and chose not to do so. Moreover, Monolith had been administratively allowed a kiln-feed, or "slurry", cutoff point (see Statement, *supra;* Br. 10) and therefore did not even have to make the election to be on a par with other cement producers. Whatever the result of the taxpayers' failure to make the statutory election, it was of their own choosing and therefore plainly nothing having a bearing on collateral estoppel.

C. The Various Matters Which the Taxpayers Assert the Supreme Court Did Not Consider in Its Monolith Opinion Go to the Merits, Which the Supreme Court Did Decide, and Do Not Preclude Application of That Decision to These Taxpayers (or to Any Others Similarly Situated.)

1. "Existing Law."

The taxpayers apparently contend that the "mining" of limestone as to integrated cement manufacturers includes all of the processes they employ to manufacture finished cement on the theory that Congress intended *Dragon Cement* and the first *Monolith* decision to be the law, rather than the Supreme Court's *Cannelton* decision interpreting the statutory definition of "min-

[28]The taxpayers also state that all cement producers will have a kiln-feed cutoff point for 1961 and later years. We fail to see any inequality or discrimination in this, and certainly the taxpayers do not claim that it results in injustice.

ing". That contention is based on the fact that in this Court's *Monolith* opinion, subsequently reversed by the Supreme Court, this Court concluded (R. 768) "that 'existing law' for the cement industry * * * must be deemed to be the Dragon Cement and first Monolith cases". That conclusion of this Court was in part based upon a reference to "existing law" in a Committee Report (which we have printed as Appendix B, *infra*) on legislation passed by Congress to give integrated cement manufacturers an election to retroactively use the pre-kiln feed stage as the cutoff point to "mining". We do not understand the Court's reasoning with reference to the Committee Report, but refer the Court to the Committee Report, which in our view plainly shows that Congress considered *Cannelton,* not *Dragon Cement* or the first *Monolith* decision to be "existing law" and that in giving integrated cement manufacturers an election to use a pre-kiln feed cutoff point (which is of course *prior* to finished cement) Congress was granting *relief* from *Cannelton* because (1) the pre-kiln feed cutoff point had been previously allowed administratively under a revenue ruling quoted in the Committee Report (although this point was beyond the proper cutoff point under the subsequent *Cannelton* interpretation of the statutory definition of "mining"), (2) the pre-kiln feed cutoff point had been adopted for 1961 and later years (in legislation designed to *preclude* depletion on finished products), and (3) Congress desired to forestall litigation by cement producers, such as these taxpayers, seeking depletion on finished cement despite *Cannelton.*

The taxpayers now assert (Br. 71-72) that the "issue" as to "existing law" discussed in this Court's

Monolith opinion, *i.e.,* the law as to integrated cement manufacturers who did not make the statutory election, "was not presented to, discussed or decided by the Supreme Court in *Monolith*". We disagree. That was the precise "issue" which was presented to the Supreme Court. And the Supreme Court decided the issue by applying *Cannelton* and holding that the "mining" of limestone terminated at the crushed limestone stage. At this point, the taxpayer's contention is nothing less than a request that this Court disregard a Supreme Court decision and hold that the District Court was not required to follow the Supreme Court's mandate in *Monolith.*

The taxpayer's primary error, of course, is in assuming that one of the reasons given by this Court for its holding in *Monolith* constitutes an "issue". In addition, the taxpayers are making the anomalous assumption that this Court's interpretation of what Congress thought to be "existing law" takes precedence over a Supreme Court decision which constitutes "existing law". True, Congress could have changed the result under *Cannelton* as to integrated cement manufacturers by changing the law. But it did not do so, except to allow an election which these taxpayers could have but did not exercise. And that election was to use a cutoff point which was *prior* to finished cement.

2. "Retroactivity."

The taxpayers assert (Br. 42) that the most important single "issue" is whether the *Cannelton* construction of the statutory definition of "mining" should be applied "retroactively". The taxpayers apparently contend that a Supreme Court decision interpreting a statute should not be given effect because lower courts

have previously interpreted the same statute differently. And they take this position despite the fact that in *Monolith* the Supreme Court expressly applied *Cannelton* to an integrated cement manufacturer, one of the taxpayers in this very case. As in their other arguments, the taxpayers are evidently asking this Court to say that the Supreme Court's *Monolith* opinion and mandate should be disregarded.

Even the taxpayers' arguments relative to "retroactivity", which seem to culminate with a discussion of *James v. United States,* 366 U.S. 213, are misconceived. It is one thing for the Supreme Court to say that its decision in *James,* overruling one of its own prior decisions (*Commissioner v. Wilcox,* 327 U.S. 404), was not to be applied retroactively and quite another thing to say that "retroactivity" is involved when the Supreme Court, deciding an issue for the first time, decides that issue contrary to prior lower court decisions. Moreover, "retroactivity" was not even involved in *James* in any true sense. As the Supreme Court there pointed out (p. 221), that case involved a felony conviction under statutes requiring that the taxpayer "willfully" failed to account for his tax or that he "willfully" attempted to evade his obligation. What the Supreme Court held (pp. 221-222) was that "the element of wilfulness could not be proven in a criminal prosecution for failing to include embezzled funds in gross income in the year of misappropriation so long as the statute contained the gloss placed upon it by Wilcox at the time the alleged crime was committed."

The taxpayers also discuss "*The Policy Against Retroactive Tax Legislation*". (Br. 62-65.) No retroactive tax *legislation* is involved in these cases; the Supreme

Court does not legislate when it interprets a statute. Indeed, the *Cannelton* decision was based on the legislative history of the statute—what the Supreme Court called (364 U.S., p. 87) "authoritative congressional action" which was so clear that the Court "need not tarry to deal with any differences which are said to have existed in administrative interpretation".

Under the heading of "*The Need for Non-Retroactivity in These Cases*" (Br. 65-70), the taxpayers purport to state facts in support of a statement (Br. 66) that "the present cases present an aggravated case of the frustration of justifiable reliance upon settled law * * *." They state (Br. 69) that the financial effect on the Monolith companies, if the Supreme Court's *Cannelton* and *Monolith* decisions are obeyed, "will be nothing short of astronomic and catastrophic" because "Having shaped their conduct for years in reliance upon what they reasonably believed to be settled law, such companies were ill-equipped to produce the 3-4 million dollars in ready cash to meet the exaction the Treasury now demands".

Wholly aside from the fact that what a taxpayer believes to be the law is not controlling, we point out that the facts are quite different from the taxpayers' representations. For the taxable years involved in these two cases, both Monolith and Midwest, as they admit (Br. 10-11), claimed depletion allowances in their tax returns in accordance with the Treasury Regulations and their interpretation, *i.e.*, by using the "slurry" (or pre-kiln feed) stage as the cutoff to "mining". Later they sought to take advantage of Courts of Appeals' decisions to obtain tax refunds. In doing so, they were not relying upon "settled law", for the law was

not authoritatively settled until the Supreme Court's decision in *Cannelton* or, taking into account this Court's *Monolith* decision, until the Supreme Court's reversal of this Court in *Monolith*. During that time, these cases have been pending. After *Cannelton* Congress granted relief from *Cannelton* to integrated cement manufacturers, including these taxpayers, but only to the extent of giving them an election to use the pre-kiln feed state as the cutoff to "mining". Perhaps because these taxpayers had already been allowed that cutoff point administratively, they did not make the election. The results, according to our position, are simply that (1) in neither *Monolith* nor *Midwest* will the taxpayers receive the tax *windfalls* which they had perhaps hoped for and (2) in *Midwest,* in view of the Government's counterclaim and Midwest's failure to exercise its election, Midwest will have to pay a relatively small amount of deficiency taxes.[29] It seems apparent, therefore, that the taxpayers' real complaint is merely that they have been frustrated in their efforts to be placed in a more advantageous position tax-wise than all other integrated miner-manufacturers, including all other integrated cement manufacturers.

3. Classification of the Taxpayer's Mineral.

While the taxpayers do not expressly argue the point, their brief contains portions (see Br. 6-10, 21-22, 28-29) indicating reliance upon the Supreme Court's failure in its *Monolith* opinion to consider the question of the proper classification of Monolith's limestone for depletion purposes. There was no such issue before the Supreme Court in *Monolith.*

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[29]A hasty computation indicates that the amount of deficiency taxes owed by Midwest is around $16,000 for 1951 and $2,400 for 1952, plus interest.

Nor is there any such issue now before this Court in either *Monolith* or *Midwest*. The taxpayer's appeal in *Monolith* is from the judgment of the District Court dismissing its action (R. 831) on the basis of its holding that the cutoff point to "mining" is when the limestone reached the crushed stage. In *Midwest* the District Court held (MR. 1304) that Midwest's limestone is classifiable as "calcium carbonates", which covers ordinary limestone (as distinguished from limestone of chemical or metallurgical grade)[30] and is depletable at a 10 percent rate. Neither party has appealed from that holding.

Conclusion.

In *Monolith* the District Court's judgment should be affirmed. In *Midwest* the District Court's judgment should be reversed and the case remanded for the entry of judgment in favor of the United States on its counterclaim.

Respectfully submitted,

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March, 1964.

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[30]See *H. Frazier Co. v. United States*, 302 F. 2d 521 (Ct. Cl.)

Certificate.

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: 10th day of March, 1964.

LOYAL E. KEIR,
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APPENDIX A.

Internal Revenue Code of 1939.

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. * * *

For percentage depletion allowable under this subsection, see section 114(b), (3) and (4).

(n) *Basis for Depreciation and Depletion.*—The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be as provided in section 114.

* * * * *

(26 U.S.C. 1952 ed., Sec. 23.)

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * *

(b) *Basis for Depletion.*—

(1) *General rule.*—The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113(b) for the purpose of determining the gain

upon the sale or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.

* * * * *

(4) [as amended by Sec. 145(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, and Sec. 319(a) of the Revenue Act of 1951, c. 521, 65 Stat. 452] *Percentage depletion for coal and metal mines and for certain other mines and natural mineral deposits.*—

(A) *In General.*—The allowance for depletion under section 23(m) in the case of the following mines and other natural deposits shall be—

(i) in the case of sand, gravel, slate, stone (including pumice and scoria), brick and tile clay, shale, oyster shell, clam shell, granite, marble, sodium chloride, and, if from brine wells, calcium chloride, magnesium chloride, and bromine, 5 per centum,

(ii) in the case of coal, asbestos, brucite, dolomite, magnesite, perlite, wollastonite, calcium carbonates, and magnesium carbonates, 10 per centum,

(iii) in the case of metal mines, aplite, bauxite, fluorspar, flake graphite, vermiculite, beryl, garnet, feldspar, mica, talc (including pyrophyllite), lepidolite, spodumene, barite, ball clay, sagger clay, china clay, phosphate rock, rock asphalt, trona, bentonite, gilsonite, thenardite, borax, fuller's earth, tripoli, refractory and fire clay, quartzite, diatomaceous earth, metallurgical grade limestone, chem-

ical grade limestone, and potash, 15 per centum, and

(iv) in the case of sulfur, 23 per centum, of the gross income from the property during the taxable year, excluding from such gross income an amount equal to any rents or royalties paid or incurred by the taxpayer in respect of the property. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance under section 23(m) be less than it would be if computed without reference to this paragraph.

(B) [as added by Sec. 124(c) of the Revenue Act of 1943, c. 63, 58 Stat. 21, and amended by Sec. 304(d) of the Excess Profits Tax Act of 1950, c. 1199, 64 Stat. 1137, and Sec. 207(a) of the Revenue Act of 1950, c. 994, 64 Stat. 906] *Definition of Gross Income from Property.* —As used in this paragraph the term "gross income from the property" means the gross income from mining. The term "mining" as used herein shall be considered to include not merely the extraction of the ores or minerals from the ground but also the ordinary treatment processes normally applied by mine owners or operators in order to obtain the commercially marketable mineral product or products, and so much of the transportation of ores or minerals (whether or not by common carrier) from the point of extraction from the ground to the plants or mills in which the ordinary treatment processes are applied thereto as is not in excess of 50 miles

unless the Secretary finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills. The term "ordinary treatment processes," as used herein, shall include the following: (i) In the case of coal—cleaning, breaking, sizing, and loading for shipment; (ii) in the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment; (iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product —sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; (iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores. The principles of this subparagraph shall also be applicable in determining gross income attributable to mining for the purposes of sections 450 and 453.

* * * * *

(26 U.S.C. 1952 ed., Sec. 114.)

Treasury Regulations 118 (1939 Code.)

Sec. 39.23(m)-1 [as amended by T.D. 6096, 1954-2 Cum. Bull. 69]—[31] *Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.*—* * *

* * * * *

(e) As used in sections 114(b)(3) and 114(b)(4)(A) and §§ 39.23(m)-1 to 39-23(m)-19, inclusive, the term "gross income from the property" means the following:

* * * * *

(3) If the taxpayer sells the crude mineral product of the property in the immediate vicinity of the mine, "gross income from the property" means the amount for which such product was sold, but, if the product is transported or processed (other than by the ordinary treatment processes described below) before sale, "gross income from the property" means the representative market or field price (as of the date of sale) of a mineral product of like kind and grade as beneficiated by the ordinary treatment processes actually applied, before transportation of such product (other than transportation treated, for the taxable year, as mining). If there is no such representative market or field price (as of the date of sale), then there shall be used in lieu thereof the representative market or field price of the first marketable product resulting from any process or processes (or, if the product

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[31]There are no final Regulations promulgated under the Internal Revenue Code of 1954. For proposed Regulations on this subject see 21 Fed. Register, part 8, pp. 8439, 8440-8452 (November 3, 1956).

in its crude mineral state is merely transported, the price for which sold) minus the costs and proportionate profits attributable to the transportation (other than transportation treated, for the taxable year, as mining) and the processes beyond the ordinary treatment processes. If the taxpayer establishes to the satisfaction of the Commissioner that another method of computation, other than the computation of profits proportionate to costs, clearly reflects the gross income from the property, then such gross income shall be computed by the use of such other method.

(f)(1) The term "ordinary treatment processes," as used in §§ 39.23(m)-1 to 39.23(m)-19, inclusive, shall include the following:

(i) In the case of coal—cleaning, breaking, sizing, and loading for shipment;

(ii) In the case of sulfur—pumping to vats, cooling, breaking and loading for shipment;

(iii) In the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering (agglomerating by incipient fusion) to bring to shipping grade and form, and loading for shipment;

(iv) In the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and minerals which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystalization, precipitation, or by sub-

stantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the mineral. The furnacing of quicksilver ores is included in the term "ordinary treatment processes." The following processes are not included in the term "ordinary treatment processes": electrolytic deposition, roasting, thermal or electric smelting, refining, or substantially equivalent processes.

(2) In addition, a treatment effecting a chemical change, the blending with other material, a thermal action, and the fine pulverization, pressing into shape or molding, are not included in the term "ordinary treatment processes" unless such processes are (i) otherwise provided for in subdivisions (i), (ii), (iii), or (iv), of subparagraph (1); (ii) necessary or incidental to the processes provided for in subdivisions (i), (ii), (iii), or (iv) of subparagraph (1); or (iii) necessary to bring the ores or minerals into condition or form suitable for shipment (for example, the agglomeration of concentrates).

(3) For the purposes of subdivisions (iii) and (iv) of subparagraph (1), the terms "concentration" or "concentrating" mean the process of eliminating waste or of separating two or more minerals or ores.

* * * * *

(h) As used in paragraphs (e) and (f) of this section, the term "crude mineral product" means the product in the form in which it emerges from the mine or well.

APPENDIX B.

S. Rep. No. 1910, 86th Cong., 2d Sess., pp. 7-10

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VI. ELECTION AS TO BASE FOR DETERMINING PERCENTAGE DEPLETION DEDUCTION IN THE CASE OF MINERALS USED IN MAKING CEMENT (SEC. 7)

A. *General Explanation*

To determine the percentage depletion allowance under present law, it is necessary to multiply the percentage rate applicable to the particular mineral by the value of the mineral at the point at which the mining process ends. This point is referred to as the "cutoff point." In the case of many mineral industries this cutoff point has been the subject of uncertainty and litigation. Included in this group is the cement industry.

In 1953 the Treasury Department published a ruling which provided that the cutoff point for taxpayers in the cement industry occurs approximately when the ground material is ready for introduction into the kiln. The ruling was as follows:

SECTION 114.—BASIS FOR DEPRECIATION AND DEPLETION

Regulations 118, Section 39.114-1: Basis Rev. Rul. 290 for allowance of depreciation and depletion.
(Also Section 23(m), Section 39.23(m)-1.)

Internal Revenue Code

Determination of the processes properly included in mining under section 114(b)(4)(B) of the In-

ternal Revenue Code, with respect to calcium carbonates and shale mined for use in the manufacture of cement.

Advice is requested concerning the position of the Internal Revenue Service on the determination of the processes properly included in mining with respect to calcium carbonates and shale mined for use in the manufacture of cement.

It is the position of the Internal Revenue Service that calcium carbonates and shale, mined for use in the cement industry, are not customarily sold in the form of the crude mineral product, and that, therefore, under section 39.23(m)(1)(f) of Regulations 118, crushing and grinding are considered "ordinary treatment processes" in the computation of gross income from the property for percentage depletion purposes. Blending with other material after crushing and grinding, such as that occurring at the kiln feed bins, is excluded from "ordinary treatment processes," but where mixing of the calcium carbonates and shale occurs before or during crushing and grinding, it will be considered as incidental to such processes.

The gross income for percentage depletion purposes must of course be computed separately with respect to each component mineral, notwithstanding any such mixing. The net income for purposes of the limitation on percentage depletion should also be computed separately for each component mineral unless the minerals are produced from the same "property." See Revenue Ruling 76, C.B. 1953-1, 176.

> In view of the specific detailed listing in section 114(b)(4)(A) of the Internal Revenue Code, percentage depletion is not allowable on clay used in the manufacture of cement unless the clay so used definitely comes within one of the specific classifications in that section.

Many cement producers did not accept this cutoff point, but contended that the cutoff point does not occur until finished cement is obtained. This dispute and disputes with producers of other minerals over the cutoff point question resulted in a series of court decisions concluding with the recent Supreme Court case of *U.S. v. Cannelton Sewer Pipe Co.* This decision laid down certain guidelines to aid in resolving cutoff point disputes.

In order to resolve the cutoff point question for 1961 and future years, Congress in the Public Debt and Tax Rate Extension Act of 1960 modified a provision of the Code (sec. 613(c)). As amended, this statutory provision established specific cutoff points for numerous minerals, including those used in the manufacture of cement. This cutoff point for cement-producing minerals (except for preheating of the kiln feed) occurs just prior to the introduction of the kiln feed into the kiln. This is derived from the previous ruling of the Treasury Department.

Although the recent legislation determines the cutoff point for the cement industry for future years, it does not settle this question for any open years prior to

1961. It is understood that for these prior years the Government may well contend that under the *Cannelton* decision the cutoff point for the minerals in question occurs at an earlier stage of processing than set forth in the previous ruling. On the other hand, it is understood that certain taxpayers in the cement industry take the position that the principles enunciated in the *Cannelton* case do not apply to them, and that they are entitled to depletion on the basis of finished cement for years prior to 1961. Under such circumstances there is a reluctance to settle cases for the past years on the basis of the published ruling and it is probable that in the absence of this amendment there would be continued and widespread litigation in this area.

Your committee is of the opinion that it is desirable to encourage the settlement of the cutoff point question in the cement industry for the years prior to 1961 on the basis of the cutoff point established by the previous administrative practice of the Treasury Department and adopted by Congress for future years. Extensive litigation in this area would be burdensome both to the Government and to the taxpayers, and also uncertain as to its results. In order to encourage the settlement of this question, section 7 of the bill as amended by your committee permits taxpayers mining minerals used in making cement to elect to apply, for the years prior to 1961, the cutoff point provisions adopted in the Public Debt and Tax Rate Extension Act of 1960. Under this proposal, if a taxpayer failed

to make the election, the cutoff point in his case for these years would be determined under existing law.

Under your committee's amendment, any taxpayer in the cement industry who wishes to avoid the continuance of litigation may make the election to accept the established cutoff point for 1960 and earlier years. If a taxpayer makes the election, it will apply to all of his mineral properties used in making cement and to all of his open taxable years before 1961, thus finally establishing the cutoff point in his case. However, the making of the election resolves only the point at which the cutoff occurs and does not deal with any other matters that may be in issue, such as the method of computing the gross income at that point.

Under the bill, the election must be made by the taxpayer on or before 60 days after the date of publication of final regulations on this provision. Once made, the election is irrevocable. The manner of making the election is to be prescribed by Treasury regulations.

B. *Technical Explanation*

This section, for which there is no corresponding provision in the House bill, amends subsection (c) of section 302 of the Public Debt and Tax Rate Extension Act of 1960 (Public Law 86-564; 74 Stat. 293) relating to the effective date of section 302.

Paragraph (1) of subsection (c) provides that subsections (a) and (b) of section 302 shall be applicable only with respect to taxable years beginning after De-

cember 31, 1960, except as provided in paragraph (2) relating to calcium carbonates and other minerals when used in making cement.

Paragraph (2) of subsection (c) provides a special effective date provision for section 302(b) in the case of calcium carbonates and other minerals when used in making cement at the election of any taxpayer mining such minerals. Under subparagraph (A) of paragraph (2), the taxpayer mining minerals used by him in making cement may elect to have the provisions of section 302(b) apply for certain taxable years beginning before January 1, 1960. If a taxpayer makes the election, it applies to all calcium carbonates and other minerals mined and used by him in making cement. The election does not apply to any minerals not used in the manufacture of cement that the taxpayer may also be mining.

If the election is made by the taxpayer, the amendments made by section 302(b) apply to all taxable years subject to the 1954 code for which the election is effective. In addition, provisions having the same effect as the amendments made by section 302(b) are deemed to be included in the 1939 code in lieu of the corresponding provisions of the 1939 code and shall apply to all 1939 code years for which the election is effective. The provisions that are deemed to be included in the 1939 code apply in determining gross income from mining for purposes of sections 450 and 453 of the 1939 code, relating to the excess profits tax.

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APPENDIX C.

Table of Exhibits.

United States and Riddell, District Director v. Monolith Portland Midwest Company (Case No. 18505)

Exhibits	Identified (Tr. page)	Received As Evidence (Tr. page)	Rejected As Evidence (Tr. page)
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2	458	458	
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16	248	248	
17	248	248	
18	251	251	
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20	262	262	
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22	410	411	
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Exhibits	Identified (Tr. page)	Received As Evidence (Tr. page)	Rejected As Evidence (Tr. page)
25	414	416	
26	420	425	
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30	433	532	
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32-A	529	532	
33	484	484	
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35	486	486	
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44	727		729 Excluded under Rule 43(c)
45	839	839	
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D	733	733	
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F	735	735	
G	735	735	
H	737	737	
I	737	737	
J	737	737	
K	738	738	
M	739	739	
N	250	250	
O	252	252	
P	255	255	
Q	255	255	
R	255	255	
S	256	256	
T	256	256	
U	257	257	
V	257	257	
W	258	258	
X	605	605	
Y	615	740	
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CC	783	784	
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